

Pension Obligation Bonds
Commonwealth of Massachusetts
Issuance Criteria
April 23, 2004

Recently enacted, as well as pending home rule legislation regarding the use of pension obligation bonds in named communities stipulates that such bonds may be issued only if, at a minimum, a comprehensive plan is first approved by the Secretary for Administration and Finance.

To facilitate submissions by relevant municipalities, the Executive Office for Administration and Finance (A&F) promulgates the following guidelines:

1. A city or town operating its own retirement system:

- a. The local appropriating authority of the city or town must approve the issuance of pension obligation bonds by a two-thirds vote;
- b. The following disclosure language must be accepted by a two-thirds vote, in a town, by the board of selectmen; in a city, by the council with the mayor's approval when required by law; and in a municipality having a town council form of government, by the town council:

THE USE OF PENSION OBLIGATION BONDS MAY INCREASE THE POTENTIAL LOSSES ASSOCIATED WITH PENSION FUND INVESTMENTS. THE COMMONWEALTH IS NOT RESPONSIBLE FOR ANY LOSSES INCURRED BY A MUNICIPALITY DUE TO THE ISSUANCE OF PENSION OBLIGATION BONDS, NOR FOR ANY INCREASE IN UNFUNDED ACTUARIAL ACCRUED LIABILITY DUE TO DEFICIENT INVESTMENT RETURNS.

2. Approval by the Executive Office for Administration and Finance

- a. With regard to cities and towns with credit ratings of "Aa3/AA-" or higher, A&F will ascertain to its satisfaction that:
 - i. Credit Ratings
 1. The city or town is rated by at least two nationally recognized rating agencies;
 2. The city or town's credit rating will not decline below the "Aa3/AA-" category as a result of the issuance of pension obligation bonds.
 - ii. Pension Obligation Bond Structuring
 1. The pension obligation bonds will have a final maturity no later than 2028;
 2. The debt service associated with the pension obligation bonds for the first three fiscal years subsequent to their issuance will be at least equal to the minimum payments required by an amortization schedule that fully funds the unfunded actuarial accrued liability by 2028 and restricts the increase in amortization payments to no more than 4.5% per year.

- iii. Present Value Savings
 - 1. A pension obligation bond issue is projected to generate net present value savings;
 - 2. Present value cash flow savings will be measured as the difference between debt service payments for the pension obligation bonds and the payments that would have been required in lieu of the issuance of pension obligation bonds, based on an amortization schedule that funds unfunded actuarial accrued liability by 2028 and restricts the increase in amortization payments to no more than 4.5% per year;
 - 3. The discount rate will be the true interest cost of the pension; obligation bond issue, including all premiums, discounts, fees, insurance cost and other expenses.
 - iv. The city or town has complied with guideline 1(b) above.
 - v. A&F will issue an approval letter to the city or town upon proof of compliance with guideline 2(a) i-iv.
 - b. With regard to cities or towns with credit ratings lower than "Aa3/AA-", but higher than "Baa2/BBB" A&F will ascertain to its satisfaction that:
 - i. Credit Ratings
 - 1. The city or town is rated by at least two nationally recognized investor rating agencies;
 - 2. The city or town's credit rating will not decline as a result of the issuance of pension obligation bonds.
 - ii. Pension Obligation Bond Structuring
 - 1. The pension obligation bonds will have a final maturity no later than 2028;
 - 2. The debt service associated with the pension obligation bonds for the first five fiscal years subsequent to their issuance will be at least equal to the minimum payments that would have been required in lieu of the issuance of pension obligation bonds, based on an amortization schedule that funds unfunded actuarial accrued liability by 2028 and restricts the increase in amortization payments to no more than 4.5% per year.
 - iii. Present Value Savings
 - 1. A pension obligation bond issue is projected to generate net present value savings;
 - 2. Present value cash flow savings will be measured as the difference between debt service payments for the pension obligation bonds and the payments that would have been required in lieu of the issuance of pension obligation bonds, based on an amortization schedule that funds unfunded actuarial accrued liability by 2028 and restricts the increase in amortization payments to no more than 4.5% per year;
 - 3. The discount rate will be the true interest cost of the pension obligation bond issue, including all premiums, discounts, fees, insurance cost and other expenses.
 - iv. Financial Capacity
 - 1. A city or town must possess the financial capacity to address additional unfunded liabilities that may arise should returns on pension assets be below the assumed rate of return;
 - 2. A&F's analysis will include, but not be limited to the following:
 - a. Tax levy capacity
 - b. Reserves

- c. Debt levels
 - d. Management
- v. Pension Fund Historical and Projected Return Performance
 - 1. The city or town's historical rate of return on its pension fund over the prior 10-year period must be equal to or greater than its current rate of return assumption.
- vi. Pension Fund Management
 - 1. The retirement system's pension assets must be managed by PRIM or by a nationally recognized asset management company;
 - 2. The city or town must provide an asset allocation plan for the proceeds of the pension obligation bond to A&F and PERAC.
- vii. Subsequent to A&F Approval:
 - 1. The city or town must provide A&F with the value of its pension fund on a "mark-to-market" basis no earlier than 60 days prior to the issuance of pension obligation bonds;
 - 2. The city or town will conduct an actuarial valuation of its pension assets once every year and report its findings to both A&F and PERAC. If the actuarial valuation of pension assets is less than projected pension liabilities, the city or town must fund this deficiency based upon a PERAC approved schedule.
- c. City or towns with credit ratings below "Baa1/BBB+" will not receive written approval from A&F to issue pension obligation bonds.
- d. Notwithstanding any provision herein to the contrary, A&F reserves the right to disapprove any request for the issuance of pension obligation bonds; A&F further reserves the right to require the submission of any materials or information it deems necessary for its determination or to waive any requirement listed above.